

Internal Revenue Service  
District Director

Department of the Treasury  
EP/EO  
P.O. Box 2508  
Cincinnati, OH 45201

Person to Contact:

Telephone Number

Refer Reply to:  
EP/EO

Employer Identification Number:

Date: DEC 13 1996

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code and we have concluded that you do not.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a trust or Form 1120 if you are a corporation or an unincorporated association. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe that it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues". The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the Office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office, or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

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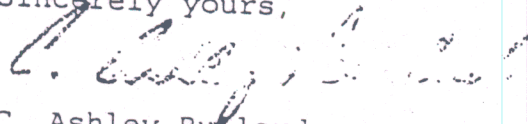
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If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides in part that:

A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination.

Sincerely yours,



C. Ashley Bullard  
District Director

Enclosures: 3

ENCLOSURE I

Facts

Information submitted with your application indicates that you were incorporated in [REDACTED]. Your Articles of Incorporation and Articles of Amendment state that you are organized exclusively for charitable, religious, educational, and scientific purposes. Specifically, you stated that you serve a charitable purpose by distributing funds to "nonprofit environmental groups world wide".

You are a membership organization. You currently have about one hundred members. According to the Bylaws and information in the application, a member must be at least eighteen years of age and make a donation of \$100 to your organization. Your sole support is from the \$100 donation from each member upon joining your organization. Members recruit additional members "through networking of existing business and personal relationships".

Your Bylaws indicate that members are entitled to earn fees on criteria set forth in the "Membership Rules". When asked to provide a copy of the "Membership Rules", membership application and agreements concerning fees, you stated that they are being revised at this time. You then explained that a member receives fees for recruiting new members. A member earns fees per the following schedule:

- \$ [REDACTED] for recruiting a new member A
- \$ [REDACTED] for every new member B recruited by A
- \$ [REDACTED] for every new member C recruited by B

You stated that this on-going membership drive is to increase your donation base. You indicated that you are using members to recruit new members in lieu of professional solicitors because paying members saves substantial amount of money.

Your organization is not otherwise engaged in other activities.

Your organization is under the control of the founder, [REDACTED], also the sole member of the Board of Directors, serving as Executive Director, President, Treasurer and Secretary concurrently. All corporate matters must be approved by [REDACTED] including the approval and suspension of members. His compensation is set at [REDACTED] of the total membership donations received by your organization. In addition, he is accorded the same fees as members receive when he recruits new members.



~~REDACTED~~

Early in the review process of your application, you were asked to instate unrelated and uncompensated individuals from your community to the Board of Directors. You declined.

You informed the Service that you have restructured the expenditure profile as follows:

recruitment fees paid to members	█%
expenses:	
(telephone, supplies,	
postage, computer expenses)	█
founder's compensation	█
contributions to other	█
organizations	
	<hr/>
	100%

Law

Section 501(c)(3) of the Internal Revenue Code provides for the exemption from Federal income tax of those organizations that are organized and operated exclusively for charitable, educational, or religious purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states that in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the Regulations states that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the Regulations states that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations states that an organization is not operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. It must not be operated for the benefit of private interests.

Section 1.501(a)(1)-1(c) of the Regulations states that the words "private shareholder or individual" mean an individual having a personal and private interest in the activities of the organization.

#### Application of Law

Based on the information presented in your application, we believe that you are operated for private interests. Private interests in this case are two-fold: inurement to the founder and inurement to members.

In Revenue Ruling 69-383, 1969-2 C.B. 113, a tax exempt hospital entered into a contract with a radiologist after arm's-length negotiations. The contract provided for the radiologist to be compensated by receiving a percentage of the gross receipts of the radiology department. The revenue ruling concluded that the agreement did not jeopardize the hospital's exempt status under section 501(c)(3) of the Code. In support of this conclusion, the following facts were noted: the agreement was negotiated on an arm's-length basis, the radiologist did not control the hospital, the amount received under the contract was reasonable in terms of the responsibilities and duties assumed, and the amount received under the contract was not excessive when compared to the amounts received by other radiologists in comparable circumstances.



[REDACTED]  
[REDACTED]

In contrast, the situation in the following court case gave rise to inurement. In People of God Community v. Commissioner, U.S. Tax Court, 75 T.C. 127, the Court noted that there was no upper limit on the amount of compensation the minister could receive. Because there was no upper limit, the Court found that a portion of the church's income was simply being passed on to its minister.

Inurement was present in the above court case because the individual stands in a relationship with the organization which offers him the opportunity to make use of the organization's income or assets for personal gain. As was in that case, your organization is controlled by [REDACTED] who also determines his own compensation.

Based on the recruitment program described in the above Facts section, compensation to members, [REDACTED] included, also constitutes inurement. By using members to recruit other members, and therefore funds, for a fee, your organization is operating like a professional fund raiser. By operating like a fund raiser, you become a vehicle for members, [REDACTED] included, to make money for themselves.

Members not only receive money for recruiting new members; they also make money when members recruited by them recruit other members, and so on. The \$[REDACTED] "donation" from each member upon joining your organization is in fact not a donation, but a fee to "buy" into a money making opportunity. By initially "buying" into such an arrangement, a member continues to enjoy residual financial benefits when other members recruit yet newer members. In this way, they have gained a proprietary interest in the organization not unlike that of a shareholder in a stock based organization.

It is the purpose and not the nature of the activities which govern the application of the operational test. Since a given activity may serve both exempt and nonexempt purposes, the operational test is satisfied only if the predominate motivation underlying such activity is an exempt purpose. Your purpose is to provide a vehicle for the founder and members to operate a professional fund raising business.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single nonexempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

[REDACTED]

[REDACTED]

# CONCLUSION

Based on the facts and circumstances, you serve the private interests of both [REDACTED] and members, thus precluding you from being operated exclusively for exempt purposes within the meaning of section 1.501(c)(3)-1(d)(1) of the Regulations. The benefits to [REDACTED] and members constitute inurement in violation of section 1.501(c)(3)-1(c)(2) of the Regulations.

Accordingly, we conclude that you do not qualify for exemption under section 501(c)(3) of the Code.

Department of the Treasury Internal Revenue Service  
**Consent to Proposed Adverse Action**  
(All references are to the Internal Revenue Code)

Prepare in  
Duplicate

Case Number

Date of Latest Determination Letter

Employer Identification Number

Date of Proposed Adverse Action Letter

Name and Address of Organization

DEC 19 1996

I consent to the proposed adverse action relative to the above organization as shown by the box(es) checked below. I understand that if Section 7428, Declaratory Judgments Relating to Status and Classification of Organizations under Section 501(c)(3), etc. applies, I have the right to protest the proposed adverse action.

**NATURE OF ADVERSE ACTION**

- ☒ Denial of exemption
- ☐ Revocation of exemption, effective
- ☐ Modification of exempt status from section 501(c)( ) to 501(c)( ), effective
- ☐ Classification as a private foundation (section 509(a)), effective
- ☐ Classification as a non-operating foundation (section 4942(j)(3)), effective
- ☐ Classification as an organization described in section 509(a)( ), effective
- ☐ Classification as an organization described in section 170(b)(1)(A)( ), effective

If you agree to the adverse action shown above, please sign and return this consent. You should keep a copy for your records.

If you sign this consent before you have exhausted your administrative appeal rights, you may lose your rights to a declaratory judgment under section 7428.

(Signature instructions are on the back of this form.)

Name of Organization

Signature and Title

Date

Signature and Title

Date